58067 D

56 pp

Nos. 06-1457 and 06-1462

IN THE

Supreme Court of the United States

MORGAN STANLEY CAPITAL GROUP INC., ET AL.,
PETITIONERS,

v.

PUBLIC UTILITY DISTRICT NO. 1
OF SNOHOMISH COUNTY, WASHINGTON, ET AL.,
RESPONDENTS.

CALPINE ENERGY SERVICES, L.P., ET AL.,
PETITIONERS,

v.

PUBLIC UTILITY DISTRICT NO. 1
OF SNOHOMISH COUNTY, WASHINGTON, ET AL.,
RESPONDENTS.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF AMICI CURIAE AMERICAN PUBLIC POWER ASSOCIATION AND NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION IN SUPPORT OF RESPONDENTS

SCOTT H. STRAUSS
Counsel of Record
SPIEGEL & MCDIARMID LLP
1333 New Hampshire Avenue, NW
Washington, DC 20036
(202) 879-4000

(Additional counsel listed on inside front cover)

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

MARK S. HEGEDUS
JEFFREY A. SCHWARZ
SPIEGEL & MCDIARMID LLP
1333 New Hampshire Avenue, NW
Washington, DC 20036
(202) 879-4000

SUSAN N. KELLY
Vice President of Policy Analysis and General Counsel
AMERICAN PUBLIC POWER ASSOCIATION
1875 Connecticut Avenue, N.W., Suite 1200
Washington, D.C. 20009-5715
(202) 467-2933

WALLACE F. TILLMAN
General Counsel
RICHARD MEYER
Senior Regulatory Counsel
NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
4301 Wilson Boulevard
Arlington, VA 22203-1860
(703) 907-5811

Counsel for Amici Curiae
American Public Power Association and
National Rural Electric Cooperative Association

TABLE OF CONTENTS

TABLE OF AUTHORITIES iii

INTEREST OF AMICI 1

STATEMENT OF THE CASE 2

SUMMARY OF ARGUMENT 8

ARGUMENT 12

I. SECTION 206 CONTAINS ONLY ONE STANDARD: THE JUST-AND-REASONABLE STANDARD 12

II. CONTRACT RATES MAY BE UNJUST AND UNREASONABLE TO CONTRACTING PARTIES OR TO THE CONSUMING PUBLIC 17

A. Contracts Are Not *Per Se* Reasonable to Signatories 18

B. MBR Authority Does Not Foreclose Review of Contract Reasonableness 27

C. Petitioners and FERC Would Unduly Limit FERC's Ability to Protect the Public Interest 32

1. FERC Must Protect More Than "Unequivocal Public Necessity" 32

2. The Ninth Circuit Correctly Interpreted Section 206 36

D. MBR Agreements Represent One of Many Contexts in Which *Mobile-Sierra* is Invoked 38

III. FERC MAY NOT ACCEPT UNREASONABLE CONTRACTS TO PROMOTE FUTURE CONTRACTING.....42

CONCLUSION 43

Farmers Union Cent. Exch. Inc. v. FERC,
734 F.2d 1486
(D.C. Cir. 1984) 19-20, 22-23

FCC v. RCA Commc'ns, Inc.,
346 U.S. 86 (1953).....35

FPC v. Conway Corp.,
426 U.S. 271 (1976).....37

FPC v. Hope Natural Gas Co.,
320 U.S. 591 (1944) 19

FPC v. Sierra Pac. Power Co.,
350 U.S. 348 (1956) .....*passim*

FPC v. Sunray DX Oil Co.,
391 U.S. 9 (1968) 21-22

FPC v. Tenn. Gas Transmission Co.,
371 U.S. 145 (1962) 20

FPC v. Texaco, Inc.,
417 U.S. 380 (1974) 14, 17-18, 21-22, 43

Interstate Natural Gas Ass'n of Am. v. FERC,
285 F.3d 18 (D.C. Cir. 2002) 19, 23, 28

Jersey Cent. Power & Light Co. v. FPC,
319 U.S. 61 (1943) 19

TABLE OF AUTHORITIES

CASES **Page(s)**

Arkansas Louisiana Gas Co. v. Hall,
453 U.S. 571 (1981).....33-35

Atlantic City Elec. Co. v. FERC,
295 F.3d 1 (D.C. Cir. 2002) 13, 24

Atlantic Refining Co. v. Pub. Serv. Comm'n,
360 U.S. 378 (1959) 9-10, 19-20

Boston Edison Co. v. FERC,
856 F.2d 361 (1st Cir. 1988).....37

Boston Edison Co. v. FERC,
233 F.3d 60 (1st Cir. 2000).....13

California ex rel. Lockyer v. FERC,
383 F.3d 1006 (9th Cir. 2004) 4, 22, 28

Consumers Energy Co. v. FERC,
367 F.3d 915 (D.C. Cir. 2004) 22

Electrical Dist. No. 1 v. FERC,
774 F.2d 490 (D.C. Cir. 1985) 28

Elizabethtown Gas Co. v. FERC,
10 F.3d 866 (D.C. Cir. 1993) 22

Louisiana. Energy & Power Auth. v. FERC,
141 F.3d 364 (D.C. Cir. 1998) 22

Maine Pub. Utils. Comm'n v. FERC,
454 F.3d 278 (D.C. Cir. 2006).....35, 40-41

NAACP v. FPC,
425 U.S. 662 (1976).....35

Northeast Utils. Serv. Co. v. FERC,
55 F.3d 686 (1st Cir. 1995).....13, 35

NSTAR Elec. & Gas Corp. v. FERC,
481 F.3d 794 (D.C. Cir. 2007).....39

Papago Tribal Util. Auth. v. FERC,
723 F.2d 950 (D.C. Cir. 1983).....13

Pennsylvania Elec. Co. v. FERC,
11 F.3d 207 (D.C. Cir. 1993).....15

Pennsylvania Water & Power Co. v. FPC,
343 U.S. 414 (1952) 20, 35

Permian Basin Area Rate Cases,
390 U.S. 747 (1968) 8, 14, 33-34, 42-43

Public Util. Dist. No. 1 of Snohomish County v. FERC, 471 F.3d 1053 (9th Cir. 2006) [Pet. App. 1a] 7

Public Utils. Comm'n of Caf. v. FERC,
462 F.3d 1027 (9th Cir. 2006).....3

Tejas Power Corp. v. FERC,
908 F.2d 998 (D.C. Cir. 1990) 20-22

Town of Norwood, Mass. v. FERC,
587 F.2d 1306 (D.C. Cir. 1978) 24-25

United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1956) ....*passim*

AGENCY DECISIONS

Bridgeport Energy, LLC,
118 F.E.R.C. ¶ 61,243 (2007).....36, 39-40

California ex rel. Lockyer v. B.C. Power Exch. Corp.,
99 F.E.R.C. ¶ 61,247 (2002) 22, 28

Californians for Renewable Energy, Inc. v. Cal. Pub. Utils. Comm'n,
119 F.E.R.C. ¶ 61,058 (2007) 3

Florida Power & Light Co.,
67 F.E.R.C. ¶ 61,141 (1994).....36

GWF Energy LLC,
98 F.E.R.C. ¶ 61,330 (2002) 29

Milford Power, LLC,
119 F.E.R.C. ¶ 61,167, *reh'g denied*,
121 F.E.R.C. ¶ 61,042, *appeal dismissed sub nom. Blumenthal v. FERC*, No. 07-1270 (D.C. Cir. Oct. 25, 2007).....40

Morgan Stanley Capital Group, Inc.,
69 F.E.R.C. ¶ 61,175 (1994), *reh'g granted in other part*, 72 F.E.R.C. ¶ 61,082 (1995). 28-29

Nevada Power Co. v. Duke Energy Trading & Mktg., LLC, 100 F.E.R.C. ¶ 61,273 (2002) [J.A. 1167a].....7, 15, 26

Nevada Power Co. v. Enron Power Mktg., Inc.,
103 F.E.R.C. ¶ 61,353 (2003)
[J.A. 1222a] .....*passim*

105 F.E.R.C. ¶ 61,185 (2003)
[J.A. 1554a] 16

Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997), [1996–2000 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 31,048, *on reh'g*, Order No. 888-B, 62 Fed. Reg. 64,688 (Dec. 9, 1997), 81 F.E.R.C. ¶ 61,248 (1997), *on reh'g*, Order No. 888-C, 82 F.E.R.C. ¶ 61,046 (1998), *aff'd in part and remanded in part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).....25

Public Utils. Comm'n of Cal. v. Sellers of Long Term Contracts:
101 F.E.R.C. ¶ 61,293 (2002)
[J.A. 1190a].....13, 15

103 F.E.R.C. ¶ 61,354 (2003)
[J.A. 1324a].....4

105 F.E.R.C. ¶ 61,182 (2003)
[J.A. 1483a].....3, 16-18

Reliant Energy Servs., Inc.,
102 F.E.R.C. ¶ 61,315 (2003).....22

San Diego Gas. & Elec. Co. v. Sellers of Energy:
92 F.E.R.C. ¶ 61,172 (2000)
[J.A. 429a] 4

93 F.E.R.C. ¶ 61,294 (2000)
[J.A. 477a] ..... *passim*

95 F.E.R.C. ¶ 61,418 (2001)
[J.A. 672a] 4

97 F.E.R.C. ¶ 61,275 (2001)
[J.A. 772a] 4, 6, 31

Wabash Valley Power Ass'n,
107 F.E.R.C. ¶ 61,327 (2004) 36

STATUTES

Federal Power Act, 16 U.S.C.
§§ 791a-825r ..... *passim*

§ 201, 16 U.S.C. § 824(a) 14

§ 205, 16 U.S.C. § 824d 15, 23, 36-37

§ 205(a), 16 U.S.C. § 824d(a) 14

§ 205(c), 16 U.S.C. § 824d(c) 27

§ 206, 16 U.S.C. § 824e ..... *passim*

§ 206(a), 16 U.S.C. § 824e(a) 12, 20, 33

Natural Gas Act, 15 U.S.C.
§§ 717- 171z 10, 20, 33-34, 43

§ 4, 15 U.S.C. § 717c 23

OTHER AUTHORITIES

Stephen Breyer, *Regulation and Its Reform* (1982) 20

Federal Energy Regulatory Commission, *Final Report on Price Manipulation in Western Markets: Fact Finding Investigation of Potential Manipulation of Electrical and Natural Gas Prices, Docket No. PA02-2-000* (2003) [Supp. J.A. 1sa] 4

S. Rep. No. 74-621 (1935) 19

BRIEF OF AMICI CURIAE AMERICAN PUBLIC POWER ASSOCIATION AND NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION IN SUPPORT OF RESPONDENTS

INTEREST OF AMICI[1]

American Public Power Association ("APPA") represents the Nation's more than 2,000 not-for-profit, publicly-owned electric utilities, which do business in every state except Hawaii and provide over 15 percent of all kilowatt-hours of electricity sold to ultimate customers. Public power systems own about 10 percent of the nation's electric generating capacity, but purchase nearly 70 percent of the power they use to serve their customers. Half of all public power systems have fewer than 2,000 customers. Respondent Public Utility District No. 1 of Snohomish County, Washington ("Snohomish"), is an APPA member.

National Rural Electric Cooperative Association ("NRECA") represents the Nation's 930 not-for-

---

[1] All parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part. No person other than *amici curiae*, their members, or their counsel made a monetary contribution to its preparation or submission.

profit, customer-owned rural electric cooperatives serving more than 40 million end users in 47 states. Of those 930 cooperatives, 64 are generation and transmission cooperatives that are owned by and sell power to their member distribution cooperatives.

Both associations' members participate in wholesale power markets as buyers *and* sellers and, accordingly, seek to ensure that: (a) well-functioning, transparent wholesale electricity markets produce just and reasonable rates, terms, and conditions; (b) the Federal Energy Regulatory Commission ("FERC") does not allow consumers and markets to be harmed by unreasonable contracts formed under uncompetitive conditions; and (c) FERC ensures that contract rates are just and reasonable to *non*-contracting parties, including the public.

STATEMENT OF THE CASE

This case presents the question whether this Court's *Mobile*[2] and *Sierra*[3] decisions (collectively, "*Mobile-Sierra*") preclude FERC from examining the justness and reasonableness of "market-based rate" ("MBR") agreements formed during the "worst

---

[2] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) ("*Mobile*").

[3] *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956) ("*Sierra*").

electricity-market crisis in American history,"[4] amidst "unprecedented" market dysfunction produced by "'flawed market rules'" and extensive "'market manipulation,'" FERC Opp. Cert. at 13, 22-23 (quoting *Californians for Renewable Energy, Inc. v. Cal. Pub. Utils. Comm'n*, 119 F.E.R.C. ¶ 61,058, P 30 (2007) ("*CARE*")).

By the summer of 2000, California electricity markets no longer worked "as intended," *id.* at 6. Short-term prices skyrocketed above "preexisting competitive levels," *id.* at 7. The California spot market peaked at $1,099 per megawatt-hour ("MWh")—"a fifteen-fold increase over the historical average." Brief for Petitioner Morgan Stanley Capital Group ("MS Br.") at 11. Pacific Northwest spot prices "reached an unprecedented $3,300/MWh." *Id.*[5]

Load-serving utilities incurred billions in debt, FERC Opp. Cert. at 6, and, in some cases, went bankrupt, J.A. 1533a. The system operator declared system emergencies and rolling blackouts.[6] The "market meltdown," J.A. 626a,

---

[4] Brief for the FERC in Opposition ("FERC Opp. Cert.") at 12.

[5] *See also* Brief of Respondents Snohomish *et al.* ("Snohomish Br.") at 12 (noting price spikes to $3,500/MWh compared to historical averages of approximately $24/MWh).

[6] *See* Brief of Respondents Pub. Utils. Comm'n of Cal. *et al.* ("PUC Br.") at 9; *see also Pub. Utils. Comm'n of Cal. v. FERC*, 462 F.3d 1027, 1040 (9th Cir. 2006) (discussing blackouts,

engulfed not just California but the entire West. FERC Opp. Cert. at 23.

Non-compliance with FERC's MBR reporting requirements, imposed to allow FERC to remedy unreasonable rates, was "rampant," *California ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1014 (9th Cir. 2004); Brief for the Federal Energy Regulatory Commission ("FERC Br.") at 9. So were schemes to manipulate electricity markets, natural gas markets (the operation of which impact electricity prices), and published electricity or natural-gas price indices. Supp. J.A. 17sa-19sa.

Then-existing rules exacerbated market flaws by relying on the "wildly dysfunctional" spot market, *see* J.A. 1462a. As Commissioner Massey explained, during high demand in California "generator bid prices [were] virtually unrestrained by the forces that would apply in competitive markets." *Id.* 459a. On investigation, FERC found that California spot market prices were unjust and unreasonable, *id.* 687a, attempted several times to stabilize the market, and undertook an extensive proceeding to consider refunds of unreasonable spot prices charged between October 2, 2000 and June 19, 2001, *see id.* 779a-80a.[7]

---

emergencies, and claims of economic and physical withholding).

[7] *See also* J.A. 709a (discussing "deficient market

On December 15, 2000, as California foundered "in a state of economic emergency," J.A. 520a, FERC acted to "stop the ... hemorrhaging," *id.* 481a, by encouraging load-serving utilities to enter into long-term power supply contracts, *id.* 538a; FERC Br. at 9. Load-serving utilities feared, however, that suddenly moving massive demand into forward markets would produce unreasonable prices in those markets. J.A. 522a. In response, FERC promised to:

> monitor prices in those markets and also adopt a benchmark that we will use as a reference point in addressing any complaints regarding the pricing of long-term contracts negotiated over the next year, after which time the sudden increase in forward demand will have subsided.

Id. FERC adopted a $74/MWh benchmark for five-year, around-the-clock power contracts, *id.* 522a-23a, to "assist buyers and sellers over the next year when so many MWs will be entering the forward market at one time," *id.* 523a-24a. FERC said that it would use the benchmark "to assess potential complaints regarding long-term contracts," but

---

mechanisms initially established by California, and approved by the Commission, that have resulted in a dysfunctional marketplace both in California and the remainder of the West").

cautioned that it should not be interpreted as "a price floor on forward contracts." *Id.*

FERC's December 15 action failed to stem the crisis. By January 4, 2001, "[t]he Western energy shortage [had] metastasized into a financial crisis of major proportions as well as a crisis of consumer confidence." J.A. 621a (Chairman Hoecker, concurring). Although he believed that "[c]ompetition is the solution, not the problem," Chairman Hoecker observed that "it was not well-conceived or well-executed in California," resulting in a "failed market structure." *Id.* 628a-30a. Two weeks later, as the crisis "deepen[ed]," Chairman Hoecker spoke to the "palpable" sense of "desperation." *Id.* 641a, 647a.

Petitioners and Respondents negotiated their contracts within this extraordinary environment, executing them between November 2000 and June 2001. J.A. 1231a. Prices in spot "and forward" markets did not "[fall] back to preexisting competitive levels" until summer 2001. FERC Opp. Cert. at 7. FERC denied rehearing regarding the $74/MWh benchmark in December 2001. J.A. 970a-71a. Respondents filed their complaints between December 2001 and February 2002. *Id.* J.A. 1232a-33a.

FERC found that Respondents established a *prima facie* case that "dysfunctional" spot markets "adversely affected the long-term bilateral contract

prices so as to render them unjust and unreasonable or contrary to public interest." J.A. 1173a. FERC denied relief, however, because it believed that *Mobile-Sierra* precluded consideration of contract reasonableness unless the contracts expressly permitted such review. FERC instead applied a "public-interest standard" under which it was "not enough to show that forward prices became unjust and unreasonable due to the impact of spot market dysfunctions; it must be shown that the rates, terms, and conditions are contrary to the public interest." J.A. 1275a-76a. FERC dismissed the complaints, finding that the public interest did not require contract modification.

The Ninth Circuit vacated and remanded FERC's orders, explaining that "there is but one statutory standard addressing the lawfulness of wholesale electricity rates[:] ... that *all* rates be 'just and reasonable.'" Pet. App. 35a. The court elaborated that FERC may not presume contract reasonableness without regard to the "context in which the contracts were initially formed" and whether that context "provide[s] a sound basis to believe that the resulting rates are just and reasonable." *Id.* 38a. The court remanded for FERC's "review [of] these complaints in the first instance" under the correct statutory standard. *Id.* 4a. These proceedings followed.

SUMMARY OF ARGUMENT

Faced with contracts negotiated at its urging amid promises of "vigilant ... monitoring," J.A. 520a, FERC abruptly reversed course and held that the Federal Power Act ("FPA"), 16 U.S.C. §§ 791a-825r, and *Mobile-Sierra* precluded just-and-reasonable review of contract rates above FERC's own "benchmark," J.A. 484a. FERC instead applied a much stricter "public-interest standard," under which it deemed irrelevant evidence that the spot market meltdown produced forward contract prices outside the zone of reasonableness. FERC here admits that "dysfunction in the spot market had an effect on the prices available in the forward market." Br. at 44.

Unlike the orders below, Petitioners and FERC now concede that there is only one statutory standard, MS Br. at 7 n.4; FERC Br. at 21, effectively admitting that the agency applied the wrong standard and that a remand was required. They nonetheless argue for reversal, claiming that FERC reached the correct *outcome* by rejecting contract modification. They contend that contracts are *per se* reasonable to the contracting parties and are just and reasonable even to *non*-parties and the consuming public except in "extraordinary circumstances" of "unequivocal public necessity." FERC Br. at 17 (quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968)); MS Br. at 6.

That position is twice flawed. First, FERC cannot be sustained on reasoning different from that in its order. Second, neither the FPA nor *Mobile-Sierra* allows FERC to presume contract reasonableness despite evidence that the contracts were tainted by the exercise of market power, market manipulation, or other uncompetitive conditions.

Grants of MBR authority do not allow FERC to treat MBR contracts as conclusively reasonable. Orders granting that authority are based on then-existing conditions and FERC's predictions of future market competitiveness. But FERC's predictions are fallible, as this case starkly illustrates. *See also* FERC Br. at 34-35. Reasonable predictions may justify waiving notice-and-filing requirements, but cannot "predetermin[e]" that subsequent MBR transactions—including those occurring in markets substantially less competitive than FERC predicted—are just, reasonable, and immune from review.

A contrary holding would require electric consumers to bear the risks of FERC's predictive errors and of market participants' anticompetitive conduct, undermining Congress's intent to "afford consumers a complete, permanent and effective bond of protection from excessive rates and charges," *Atl. Ref. Co. v. Pub. Serv. Comm'n*, 360

U.S. 378, 388 (1959).[8] Such a holding also would be inconsistent with FERC's willingness to remedy *short*-term transactions occurring during the same period, under similar market conditions, and entered into pursuant to the same MBR authority. Neither FERC nor Petitioners cite any precedent that *Mobile-Sierra*'s applicability turns on transaction duration.

Importantly, the Ninth Circuit did *not* order FERC to set these long-term contracts aside. The absence of a presumption of reasonableness does not lead inexorably to contract reform. It leads to contract review without any presumption. The Ninth Circuit correctly remanded for FERC to determine, without any presumption, whether the contracts were just and reasonable to Respondents.

The Ninth Circuit also understood that FERC failed to consider adequately the contracts' effects on the public. Petitioners would *further* circumscribe that protection, arguing that FERC lacks authority to set aside contracts, even to protect *non*-parties and the public, except in cases of "[u]nequivocal [p]ublic [n]ecessity." *E.g.*, MS Br. at 26. That constriction of FERC's authority not only would produce unjust outcomes here, but would eviscerate FERC's ability to protect the

---

[8] *Atlantic Refining* involved the Natural Gas Act ("NGA"), but this Court has interpreted that Act and the FPA *in pari materia*. *See Sierra*, 350 U.S. at 353.

public in *other* contexts, including cases where the contracting parties' interests are less aligned with the public interest than are Respondents' interests here. In other contexts, contracting parties jointly invoke *Mobile-Sierra* to insulate their contracts against challenge by affected *non*-parties. Even if contracts are (or are deemed to be), reasonable to their signatories, however, there is *no* basis for presuming reasonableness to *non*-parties and the public. The Court should clarify that the FPA does not permit contracting parties to curtail non-parties' statutory rights, and does not limit FERC to protecting only against "[e]xtensive [d]amage" to the public, MS Br. at 45.

Finally, Petitioners claim that the need to maintain "sanctity of contract" and to avoid deterring sellers from contracting during future crises justified FERC's decisions. But Congress struck a balance by permitting public utilities to set rates by contract *subject to FERC review*. The FPA does not allow FERC to sanctify contracts tainted by the exercise of market power, market manipulation, or uncompetitive conditions. Nor may FERC tolerate unjust rates now in order to spur future contracting. In any event, efficient economic outcomes require only that MBR contracts entered under *competitive* conditions be enforced. The FPA neither requires nor permits FERC to refrain from just-and-reasonable review of

MBR contracts entered under *uncompetitive* conditions.

ARGUMENT

I. SECTION 206 CONTAINS ONLY ONE STANDARD: THE JUST-AND-REASONABLE STANDARD.

Petitioners asked FERC to reform their contracts under FPA Section 206, 16 U.S.C. § 824e. That provision commands FERC to modify an existing rate "[w]henever" it finds that any such rate or "any ... contract affecting such rate" is "unjust, unreasonable, unduly discriminatory or preferential." *Id.* § 824e(a). Upon such finding, FERC must "determine the just and reasonable rate ... or contract to be thereafter observed...." *Id.*

In *Sierra*, the public utility agreed to low rates to stave off competition and then "sought to raise rates [once] the competitive threat had diminished," MS Br. at 32. This Court held that FERC's predecessor could not find the rates unreasonable "solely" or "simply" because they had become "unprofitable to the public utility." 350 U.S. at 355. While the Commission could not *impose* such rates, the public utility could agree to them and would not be "entitled to be relieved of its improvident bargain." *Id.* The Commission's sole concern then "would seem to be whether the rate is

so low as to adversely affect the public interest." *Id.*

Attempts to generalize *Sierra*'s rule to the California meltdown require an unwarranted leap. That a contract rate *prompted* by a competitive threat is reasonable (and remains so when the threat abates) does not mean that a contract rate extracted under *uncompetitive* conditions is also reasonable.

Misinterpretation of *Sierra* has led to the notion that the FPA contains *two* standards for evaluation of contract rates: a just-and-reasonable standard and a "higher," J.A. 1198a, or "'much more restrictive,'"[9] "public-interest standard." Which standard applies or which "version" of the "public-interest standard" applies has generated extensive controversy.[10] The Ninth Circuit correctly returned to the FPA's roots by recognizing, as Petitioners and FERC now concede, that the just-and-reasonable standard is the *only* standard. FERC Br. at 21; MS Br. at 7 n.4.

---

[9] FERC Br. at 38 (quoting *Atl. City Elec. Co. v. FERC*, 295 F.3d 1, 14 (D.C. Cir. 2002)).

[10] *See Boston Edison Co. v. FERC*, 233 F.3d 60, 68 (1st Cir. 2000) (discussing confusion); *compare Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 954 (D.C. Cir. 1983) *with Ne. Utils. Serv. Co. v. FERC*, 55 F.3d 686, 691 (1st Cir. 1995).

The FPA commands that "[a]*ll* rates ... shall be just and reasonable," and declares that "*any* ... rate ... that is not just and reasonable is ... unlawful." 16 U.S.C. § 824d(a) (emphasis added). The FPA imposes these requirements *because* "the business of ... selling electric energy for ultimate distribution to the public is affected with a public interest." 16 U.S.C. § 824(a). Thus, unjust and unreasonable rates are contrary to the public interest, and rates that "contravene the relevant public interests," *Permian Basin*, 390 U.S. at 784, are unjust and unreasonable.

The Act does not establish a higher public-interest standard for reviewing contract rates and a lower just-and-reasonable standard for reviewing other rates. Even if only a "small dent in the consumer's pocket" would result, "the Act makes unlawful all rates which are not just and reasonable, and does not say a little unlawfulness is permitted." *FPC v. Texaco, Inc.*, 417 U.S. 380, 399 (1974). While FERC has "great discretion as to how to insure just and reasonable rates," the FPA "does not empower it to" abandon that standard. *Id.* at 394.

Despite FERC's clear statutory obligation, it did not determine here whether the contract rates were just and reasonable.[11] Rather, FERC set for

---

[11] FERC contradicts itself when it says the "statute confers broad discretion," which it exercised by determining that it

hearing "*whether* the complainants must ... show[] that a challenged contract is contrary to the public interest, *or whether* they ... [must] show[] that the contract is not just and reasonable." J.A. 1170a (emphasis added). FERC concluded that the public-interest standard applied, and therefore deemed irrelevant evidence that the contracts were unjust and unreasonable. J.A. 1275a ("[A] finding that the unjust and unreasonable spot market prices caused forward bilateral prices to be unjust and unreasonable would be relevant to contract modification only where there is a 'just and reasonable' standard of review."); *id.* 1198a ("[T]hat a contract may be found ... unjust and unreasonable under sections 205 or 206 ... does not in and of itself demonstrate that the contract is contrary to the public interest ....") FERC's admission that the just-and-reasonable standard is the only standard (Br. at 21) itself justifies a remand so that the agency may apply the correct standard in the first instance.[12]

---

lacked discretion to modify contracts except in cases of "unequivocal public necessity." FERC Br. at 17.

[12] FERC and Petitioners emphasize the transactions' supposed "voluntariness" and Respondents' attempts to bargain for the best available rates. But "[w]hether a rate [is just and reasonable] is to be determined by FERC, not the parties to an agreement, however voluntary their agreement may be." *Pa. Elec. Co. v. FERC*, 11 F.3d 207, 210 (D.C. Cir. 1993). Moreover, if market "options" were constricted by uncompetitive factors, as FERC concedes (Br. at 44), then

Below, Petitioners asked FERC to clarify that the public-interest standard "[did] not authorize unjust and unreasonable rates." J.A. 1567a. FERC responded that rates "initially" must be just and reasonable and that its grant of MBR authority satisfied that requirement. *Id.* But that was no answer. FERC never explained why rates must be reasonable only "initially," when the FPA contains no such limitation. Nor did FERC ever examine the reasonableness of these contracts, even "initially." Rather it concluded (wrongly, as explained below) that MBR authority *predetermines* reasonableness regardless of the circumstances under which MBR contracts are negotiated. FERC never explained why MBR authority predetermines the reasonableness of subsequent long-term contracts but not short-term transactions.[13] The Ninth Circuit therefore correctly remanded the case.

Respondents' "choice" among unreasonable "options" hardly renders the resulting rates just and reasonable. FERC refused to consider claims that "available alternatives 'were not those that would have been presented in the absence of spot market dysfunction,'" because it deemed that contention "not pertinent" to a public-interest inquiry but relevant only to a just-and-reasonable review. J.A. 1527a, quoting Request for Rehearing of the California Electricity Oversight Board and the California Public Utilities Commission at 21, No. EL02-60 et al. (July 28, 2003).

[13] FERC's attempt to reconcile its treatment of long-term and short-term transactions was circular. FERC asserted that

II. CONTRACT RATES MAY BE UNJUST AND UNREASONABLE TO CONTRACTING PARTIES OR TO THE CONSUMING PUBLIC.

Conceding that only one standard exists, FERC and Petitioners argue that contracts meet that standard except in cases of "unequivocal public necessity." But while FERC may presume that *unchallenged* contracts are reasonable to the contracting parties, FERC may *not* ignore claims that market power, market manipulation, or other uncompetitive conditions tainted contract formation and led to unreasonable rates. Treating contract rates as reasonable *per se* would make markets the "final measure" of justness and reasonableness, which the FPA does not permit. *Texaco*, 417 U.S. at 397.

"spot market sales are not subject to ... the *Mobile-Sierra* doctrine, while the long-term forward contracts ... here are." J.A. 1540a. FERC reasoned that long-term buyers can negotiate for provisions "retain[ing] their rights to unilaterally file for rate changes." *Id.* But that *assumed* a functional market—an assumption that FERC viewed *Mobile-Sierra* as preventing it from examining. Moreover, even if Respondents could have obtained such provisions, the FPA does not require customers to bargain and pay for the statutory, just-and-reasonable review of rates they claim were extracted by exercise of market power, manipulation, or uncompetitive circumstances.

The FPA also prohibits FERC from "narrow[ly]" "limit[ing]" its review of contracts' effects on third parties and the public, MS Br. at 45, as there is often *no* reason to presume reasonableness to ultimate consumers or other interests unrepresented by the contracting parties. The FPA does not limit FERC to protecting only against "extensive" damage, *id.*, to the public. *See Texaco*, 417 U.S. at 399 (FPA forbids even "a little unlawfulness"). Binding FERC's hands except in "extraordinary circumstances" of "unequivocal public necessity" would rewrite the FPA and eviscerate FERC's ability to fulfill its statutory role.

A. Contracts Are Not Per Se Reasonable to Signatories.

FERC held that it lacks authority to examine a contract's reasonableness to the contracting parties absent fraud, J.A. 1507a, "bad faith, unfairness or duress," *id.* 1536a. But relegating consumers to traditional contract-law arguments—available without the FPA—ignores the reasons why Congress subjected public utilities to rate regulation in the first place. The FPA does not require FERC to treat contracts as reasonable despite the "potential effects of market dysfunction" or the absence of "effective [market] oversight," FERC Br. at 18.

Opposing *certiorari*, FERC argued that the Ninth Circuit's decision stood for "the narrow

proposition that, if there is a credible claim that severe market dysfunction has affected the formation of a market-based contract, the Commission must take that fact into account" in determining whether the contract rate is reasonable. FERC Opp. Cert. at 12. Below, FERC refused to undertake that FPA-mandated inquiry because it misunderstood *Mobile-Sierra*.

In 1935, Congress concluded that "federal regulation of the wholesale energy market was necessary" because the industry was increasingly "dominated by 'giant' vertically integrated holding companies," MS Br. at 4 (quoting S. Rep. No. 74-621 (1935) (Senate Report to the Public Utility Act of 1935)), which could not be regulated effectively or constitutionally by the States.[14] Congress was concerned that "without regulation [public utilities'] rates ... would exceed competitive rates, *i.e.*, ones approximating cost." *Interstate Natural Gas Ass'n*, 285 F.3d 18, 30 (D.C. Cir. 2002); *see also Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1508-09 (1984). Thus, while electric rates may be established initially by contract, Congress subjected those rates to regulatory review "to protect consumers against exploitation," *Hope*, 320 U.S. at 610, and "to afford consumers a complete, permanent and effective bond of protection from

---

[14] *Jersey Cent. Power & Light Co. v. FPC*, 319 U.S. 61, 67-68 & n.7 (1943); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944).

excessive rates and charges," *Atl. Ref. Co.*, 360 U.S. at 388.[15]

The FPA does not exempt contract rates from review. 16 U.S.C. § 824e(a) (requiring FERC to reform "any" unreasonable contract). While contracts *may* result from negotiations between entities with equal bargaining power (although, even then, contracting parties may not adequately protect the interests of the consuming public or other non-parties), contracts *also* may result from uncompetitive conditions involving the exercise of market power, market manipulation, or other market failure. Indeed, contracts securing the fruits of those conditions, and limiting the relief available to disadvantaged parties,[16] are *most*

---

[15] *See also FPC v. Tenn. Gas Transmission Co.*, 371 U.S. 145, 154 (1962) (Natural Gas Act "'protect[s] consumers against exploitation' ... and '...underwrite[s] just and reasonable rates to the consumers of natural gas...'") (citations omitted); *Pa. Water & Power Co. v. FPC*, 343 U.S. 414, 418 (1952) ("A major purpose of the [Power] Act is to protect power consumers against excessive prices"); *Farmers Union*, 734 F.2d at 1508 ("[M]arket failure and the control of monopoly power are central rationales for the imposition of rate regulation.") (citing Stephen Breyer, *Regulation and Its Reform* 15-16 (1982)).

[16] *Cf. Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990) ("[I]f the [seller] has significant market power with which to extract an agreement unfavorable to its ... customers, then it would not require much imagination for the [seller] also to require that they support the agreement fully before the Commission.").

likely when wholesale buyers' needs are greatest and their choices fewest. As the D.C. Circuit put it, "relying upon the [customers'] agreement begs the question whether the agreement is the product of the pipeline's exercise of significant market power." *Tejas*, 908 F.2d at 1005.

Thus, FERC is not "free under the Act to equate just and reasonable rates with the prices ... prevailing in the market place." *Texaco*, 417 U.S. at 396. As this Court has explained:

> It is abundantly clear from the history of the Act and from the events that prompted its adoption that Congress considered that the natural gas industry was heavily concentrated and that monopolistic forces were distorting the market price for natural gas. Hence, the necessity for regulation and hence the statement in *Sunray DX* that if contract prices for gas were set at the market price, this
>
> would necessarily be based on a belief that the current contract prices in an area approximate closely the "true" market price[,] the just and reasonable rate[,] [which] ... would contradict the basic assumption that has caused natural gas production to be subjected to regulation... .

Id. at 397-98 (quoting *FPC v. Sunray DX Oil Co.*, 391 U.S. 9, 25 (1968)). Having "subject[ed] producers to regulation because of anticompetitive conditions in the industry," Congress did not allow FERC to determine just and reasonable rates "conclusively ... by reference to market price." *Id.* at 399.

Following *Texaco*, lower courts limited FERC's reliance on markets to set just-and-reasonable rates to cases where the market is "competitive,"[17] and have required ongoing monitoring and assurances of remedies that check unreasonable rates.[18] As the D.C. Circuit explained, "regulation"

---

[17] *Consumers Energy Co. v. FERC*, 367 F.3d 915, 922-923 (D.C. Cir. 2004); *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866; 870 (D.C. Cir. 1993) ("[*W*]*hen there is a competitive market* the FERC may rely upon market-based prices in lieu of cost-of-service regulation to assure a 'just and reasonable' result.") (emphasis added); *Lockyer*, 383 F.3d at 1013; *Tejas Power Corp.*, 908 F.2d at 1004; *La. Energy & Power Auth. v. FERC*, 141 F.3d 364, 365- 366 (D.C. Cir. 1998); *Farmers Union*, 734 F.2d at 1510. FERC itself has emphasized that "authority to sell power at market-based rates, as opposed to at cost-based rates, depends on a functioning, competitive market for wholesale power unimpaired by market manipulation." *Reliant Energy Servs., Inc.*, 102 F.E.R.C. ¶ 61,315, P 12 (2003).

[18] *Cal. ex rel. Lockyer v. B.C. Power Exch. Corp.*, 99 F.E.R.C. ¶ 61,247, at 62,064 (2002) ("When the Commission moves to a market-based rate system, it 'must retain some general oversight over the system, to see if competition in fact drives rates into the zone of reasonableness 'or to check rates if it

that simply equates market prices with just and reasonable rates "is worse than an exemption *simpliciter*" because it "retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." *Farmers Union*, 734 F.2d at 1510.

Contrary to Petitioners' claims (MS Br. at 3-4), neither *Mobile* nor *Sierra* forbids FERC from inquiring whether uncompetitive market conditions unduly limited a contracting party's options and rendered the resulting contract unreasonable. *Mobile* held that NGA Section 4, which corresponds to FPA Section 205, does not create new rate-change rights.[19] That holding is irrelevant to cases arising, as these do, under FPA Section 206.

---

does not.' ", (quoting *Interstate Natural Gas Ass'n*, 285 F.3d at 31). According to FERC, those requirements are met by "monitoring *and FPA § 206 complaint procedures*." *Id.* at 62,062 (emphasis added); *see also* 285 F.3d at 34 (discussing "monitoring and assurance of remedies in the event of insufficient competition," including "entertain[ing] complaints ...to respond to specific allegations of market power ...").

[19] *Mobile* explained that NGA Section 4 requires public utilities to provide *notice* of rate changes but does not independently authorize them. Thus, if a public utility lacks rate-change authority (because it limited its rights by contract or otherwise), Section 205 does not expand that authority. 350 U.S. at 339.

Sierra construed FERC's authority to set aside a rate under Section 206. There, Pacific Gas and Electric Company ("PG&E") sold power to Sierra Pacific Power Company at unusually low rates "to forestall potential competition" from available low-cost hydropower. 350 U.S. at 352. "A few years into the agreement, 'when power from Shasta Dam was no longer available to Sierra,'" and the "competitive threat had diminished," MS Br. at 29, 32 (quoting *Sierra* at 352), PG&E asked FERC to increase its rates. FERC found that the contract rates (to which competitive pressures had prompted PG&E to agree) were no longer just and reasonable. This Court rejected FERC's analysis, explaining that a contract rate "may not be said to be either 'unjust' or 'unreasonable' simply because it is unprofitable to the public utility." 350 U.S. at 355.

Sierra's holding, that a contract prompted by competition does not become unjust and unreasonable simply because it seems insufficiently profitable once the "competitive threat ... diminishe[s]," MS. Br. at 32, does not allow FERC to sidestep claims that contracts formed under *un*competitive conditions were unjust and unreasonable *ab initio*. *Mobile-Sierra* requires contracting parties to live with their bargain "*assuming* that there was no reason to question what transpired at the contract formation stage." *Atl. City Elec. Co. v. FERC*, 295 F.3d 1, 14 (D.C. Cir. 2002) (emphasis added); *Town of Norwood,*

Mass. v. FERC, 587 F.2d 1306, 1313-14 (D.C. Cir. 1978). Notably, in other cases, FERC has entertained (and even invited) contract modification *because* agreements were negotiated under uncompetitive conditions.[20]

While Petitioners accuse Respondents of buyers' remorse and complain that FERC may not relieve buyers of "improvident bargains," they fail to acknowledge the extraordinary circumstances surrounding formation of the contracts at issue here. The challenged contracts were negotiated amid the "worst electricity-market crisis in American history," FERC Opp. Cert. at 12, produced in part by "flawed market rules" and extensive "market manipulation," *id.* at 22-23 (quotations omitted), in which California's market structure "failed," J.A. 630a, "desperation" was

---

[20] Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888-A, 62 Fed. Reg. 12,274, 12,285-86 (Mar. 14, 1997), [1996–2000 Regs. Preambles] F.E.R.C. Stat. & Regs. ¶ 31,048, at 30,193-94 (entertaining modification of requirements contracts on grounds that, before open access, customers were captive to monopolist transmission providers), *on reh'g*, Order No. 888-B, 62 Fed. Reg. 64,688 (Dec. 9, 1997), 81 F.E.R.C. ¶ 61,248 (1997), *on reh'g*, Order No. 888-C, 82 F.E.R.C. ¶ 61,046 (1998), *aff'd in part and remanded in part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd sub nom. New York v. FERC*, 535 U.S. 1 (2002).

"palpable," *id.* 647a, and "dysfunction in the spot market had an effect on the prices available in the forward market," FERC Br. at 44.

FERC itself urged load-serving utilities to enter forward contracts, promised to "monitor prices" in forward markets, and adopted a benchmark for use "as a reference point in addressing any complaints regarding the pricing of long-term contracts negotiated over the next year." J.A. 522a. When purchasers filed complaints, FERC found that they established a *prima facie* case that "dysfunctional" spot markets "adversely affected the long-term bilateral contract prices so as to render them unjust and unreasonable or contrary to public interest." J.A. 1173a.

These are hardly pedestrian cases of buyers' remorse over "improvident bargains" struck in functional, competitive markets. FERC's denial of relief on grounds that *Mobile-Sierra* precludes inquiry into whether the contract rates were the product of uncompetitive market conditions, J.A. 1173a, 1275a-76a, was an abdication of its statutory responsibility to ensure just-and-reasonable rates, and the Ninth Circuit was right to remand.

B. MBR Authority Does Not Foreclose Review of Contract Reasonableness.

FERC and Petitioners invoke FERC's grant of MBR authority to foreclose questioning of the market conditions under which Respondents' contracts were negotiated. In doing so, they place more weight on FERC's grant of MBR authority than it can bear. While FERC's *ex ante* review of market conditions and imposition of ongoing reporting requirements were intended "to ensure that sellers cannot exercise market power and thus that rates charged are just and reasonable," FERC Br. at 7, the facts of this case refute any implication that these measures were effective—or could be deemed effective—in guarding against market power and unjust or unreasonable rates.[21]

FERC grants MBR authority based upon its assessment of then-existing market conditions and its prediction of future conditions. While reasonable predictions may justify waiving prior notice and filing requirements,[22] no prediction is

---

[21] FERC states (Br. at 33) that its MBR "framework must be taken as a given in assessing the validity of" subsequent MBR contracts. But one may take the framework as given without indulging the fiction that it was effective.

[22] *See* MS Br. at 8-9 (noting that FERC's MBR regime was enacted "under [FERC's] statutory authority to detail the 'rules and regulations' about the 'time' and 'form' for filing of wholesale energy rates") (quoting 16 U.S.C. § 824d(c)); FERC

infallible. As FERC admits (Br. at 34), "any initial determination ... can only be based on the factual circumstances existing at the time, and those circumstances can change." Moreover, "[t]here will inevitably be situations in which a seller evades detection and is later found to have acquired market power or manipulated markets." *Id.* at 34-35. Accordingly, MBR authority cannot "predetermine[]," J.A. 1245a, that contracts negotiated under unforeseen circumstances are indisputably just and reasonable. *Cf. Elec. Dist. No. 1 v. FERC*, 774 F.2d 490, 495 (D.C. Cir. 1985) (Judge Scalia) ("[T]he Commission cannot fix a rate, as it purports to have done here, without ever seeing it.") That is one reason why FERC imposed ongoing transaction-reporting requirements (*see* n.18 *supra*), non-compliance with which was "rampant" during the relevant period. *Lockyer*, 383 F.3d at 1014.

For example, in 1994, Morgan Stanley requested "approval to sell electricity at market-based rates." *Morgan Stanley Capital Group Inc.*, 69 F.E.R.C. ¶ 61,175, at 61,691 (1994), *reh'g granted in other part*, 72 F.E.R.C. ¶ 61,082 (1995). While it granted that request, FERC did not purport to predetermine that the resulting rates would be just and reasonable. The phrase "just and reasonable" appears nowhere in the order. The

---

Br. at 28-29.

grant of "MBR authority" consisted instead of the waiver of otherwise-applicable FERC regulations requiring (among other things) prior notice and filing of rates, with cost support. *Id.* at 61,697-98. Because those waivers would prevent FERC from "hav[ing] the opportunity to examine the particular circumstances of each transaction," FERC imposed ongoing "reporting and periodic review requirements." *Id.* at 61,692. FERC explained that the reporting requirements were imposed *both* to monitor for the acquisition of market power and "to allow the Commission to evaluate the reasonableness of the marketer's charges." *Id.* at 61,696.[23]

Acknowledging that an MBR authority grant does not ensure continued market competitiveness or future just and reasonable rates (*see* FERC Br. at 34-35), FERC imposed ongoing reporting requirements (which many sellers violated) and invited customers or others who believed the prices were unjust and unreasonable to file complaints.[24]

---

[23] FERC's brief recasts the import of FERC's reporting requirements, stating only that they "place[] sellers on notice that their [MBR] authority will be subject to continuing review and, if necessary, to remedial action." Br. at 8.

[24] FERC dismissed protests of MBR rates that were filed or reported, deeming them procedurally improper and advising protestors to file formal complaints. *E.g.*, *GWF Energy LLC*, 98 F.E.R.C. ¶ 61,330, at 62,389 (2002). *See also* J.A. 522a (December 15, 2000 order establishing "benchmark" to be "use[d] as a reference point in addressing any complaints

Yet, faced with such complaints, FERC declined to determine whether rates were just and reasonable. FERC now says that "the primary remedy" upon complaint is not rate relief, but prospective revocation of MBR authority (precluding future MBR agreements but leaving existing ones unaffected), disgorgement of profits reaped through tariff violations, or "civil penalties." Br. at 35. In effect, FERC says that it will punish wrongdoers (if caught), and will protect future customers, but will allow existing consumers to remain saddled with unjust rates extracted during the "market meltdown," J.A. 626a.

That position is consistent neither with the FPA nor with FERC's response to complaints challenging *short*-term rates charged during the same period and under the same MBR authority as Petitioners' long-term contracts. In response to a complaint attacking California spot-market prices, the Commission established a refund effective date, investigated, concluded that prices were unjust and unreasonable, and began a proceeding to consider refunds of short-term rates collected from October 2, 2000 through June 19, 2001. Yet, when Respondents complained about their long-term contracts as FERC had contemplated, J.A. 522a,

---

regarding the pricing of long-term contracts negotiated over the next year").

FERC held that it had predetermined the reasonableness of those rates and denied relief.[25]

FERC is correct that "[o]nce dysfunction in the spot market occurred, it was inevitable that it would impose costs on someone," Br. at 45, but the FPA does not permit FERC to foist the costs of market dysfunction on consumers. FERC's attempts to justify that result blame the victim. "Had the purchasers believed that the rates in their contracts might become unjust and unreasonable based on future developments in the spot market, they could have insisted on a clause preserving their right to seek Commission modification of the contracts," FERC says. *Id.* But Respondents were not negotiating under competitive conditions to allocate the risk of *future* market dysfunction. They were bargaining in an *already*-dysfunctional market.[26]

---

[25] FERC also noted that there had been no finding of manipulation "*specific to*" the long-term contracts at issue. J.A. 1285. In contrast, FERC dismissed the need for such findings in concluding that short-term rates were unjust and unreasonable. *E.g.*, J.A. 824a, 933a-34a.

[26] Morgan Stanley argues (Br. at 25) that its contract was reasonable because "were market conditions to repeat the events of 2000-2001 during the remaining term of the contract, Snohomish again would reap the benefit ... of purchasing power at or below the spot market rate." But Morgan Stanley's argument is a tautology that would justify any rate. That an unreasonably high contract rate protects

C. *Petitioners and FERC Would Unduly Limit FERC's Ability to Protect the Public Interest.*

1. FERC Must Protect More Than "Unequivocal Public Necessity."

By restricting FERC's contract-modification power to "extraordinary circumstances" of "unequivocal public necessity,"[27] FERC and Petitioners not only would frustrate FERC's duty to protect contracting parties subjected to uncompetitive markets but also would limit its ability to protect *non*-parties and the public.

Such restrictions find no support in either *Mobile* or *Sierra*. *Mobile* "in no way impair[ed]" FERC's regulatory powers. 350 U.S. at 344. Instead, the decision clarified that contracts are "fully subject" to FERC's "paramount power ... to modify them when necessary in the public interest." *Id.* Although natural gas companies may

---

against even higher (and potentially less reasonable) spot prices does not render the contract rate just and reasonable under the FPA.

[27] FERC Br. at 22; MS Br. at 24, 45-46 (arguing that FERC may modify a "valid energy contract" only to avoid "extensive" or "extraordinary" damage to the public, "akin to the closing of a public utility").

not "unilaterally chang[e] their contracts simply because it is in their private interests to do so," they may obtain relief "when their interests coincide with the public interest." *Id.*

Sierra similarly acknowledged FERC's "undoubted" power under FPA Section 206(a) to modify contract rates "whenever" it finds them unlawful. 350 U.S. at 353. While FERC may not find an agreement "unreasonable solely because it yields less than a fair return," *id.* at 355, *Sierra* did not purport to limit FERC's authority to find a rate unlawful for other reasons. On the contrary, *Sierra* instructed the Court of Appeals to remand the case "for such further proceedings, not inconsistent with this opinion, as [FERC] may deem desirable." *Id.* Far from commanding FERC to refrain from modifying contracts except in cases of unequivocal public necessity, the Court remanded with guidance that, in the "circumstances" presented, FERC's concern "would seem to be" whether the rate was "so low as to adversely affect the public interest." *Id.*

Petitioners' claims regarding FERC's "highly limited" contract-modification authority, *e.g.*, MS Br. at 4, derive from misreading *dicta* in *Permian Basin* and *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981) ("*Arkla*"). *Permian Basin* explained that "[a]lthough the [NGA] is premised upon a continuing system of private contracting, [FERC]

has *plenary authority* to limit or to proscribe contractual arrangements that contravene the relevant public interests." 390 U.S. at 784 (citation omitted) (emphasis added). The Court added that FERC may not abdicate its responsibility based on "conjectures about the prospective responses of the capital market," but, rather, was "obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress." *Id.* at 791.

Arkla rejected sellers' claims for breach-of-contract damages on grounds that their "theory of the case would give inordinate importance to the role of contracts between buyers and sellers in the federal scheme for regulating the sale of natural gas." 453 U.S. at 582. In *Arkla*, a natural gas purchaser had agreed to a most-favored-nations clause but then failed to inform the seller when another transaction triggered that clause. The seller sought damages in state court, and the buyer defended on filed-rate and primary-jurisdiction grounds. *Id.* at 573-76. The seller claimed that the buyer's failure to inform it of the other transaction excused its failure to file a higher rate with FERC. *Id.* The Court rejected the seller's arguments, explaining that while "nothing in the Act *forbids* parties to set their rates by contract" that rule "does not affect the supremacy of the Act itself." *Id.* at 582. The Court held that allowing state-court damages based on the presumption that an un-filed

contract rate was reasonable would "undercut the clear purpose of the congressional scheme: granting the Commission an opportunity in every case to judge the reasonableness of the rate." *Id.*

Thus, none of the cited cases supports the claim that FERC must accept a contract as reasonable except in cases of "unequivocal public necessity." Moreover, holding FERC to such an exacting standard would eviscerate its ability to protect the "public interest"—a broad standard, *see* FERC Br. at 21 (citing *FCC v. RCA Commc'ns, Inc.*, 346 U.S. 86, 90 (1953)), that takes "content and meaning" from "the purposes for which the [FPA] [was] adopted," *NAACP v. FPC*, 425 U.S. 662, 669 (1976), including the "protect[ion] [of] power consumers against excessive prices," *id.* at 670 n.5 (quoting *Pa. Water & Power Co. v. FPC*, 343 U.S. 414, 418 (1952)).

Contrary to Petitioners' (and now FERC's) claims, courts have affirmed FERC's authority to modify contracts for the protection of third parties and the public without requiring the exacting showing that Petitioners and FERC would require. *See* FERC Opp. Cert. at 23 (citing *Ne. Utils. Serv. Co.*, 55 F.3d 686 (1st Cir. 1995); *Me. Pub. Utils. Comm'n v. FERC*, 454 F.3d 278 (D.C. Cir. 2006)).

Further, Petitioners' assertion that contracts must be accepted as reasonable except in cases of unequivocal public necessity would undermine

settled precedent regarding FERC's rejection of unreasonable contract rates when they are first filed.[28]

2. The Ninth Circuit Correctly Interpreted Section 206.

Petitioners and *amici* contend that the Ninth Circuit interpreted Section 206 to create a "heads I win, tails you lose" rule under which purchasers may challenge unfavorable contracts but sellers cannot. Brief of Coral Power *et al.* ("Coral Br.") at 26. FERC now joins the chorus, contending that the public-interest standard "protects *both* buyers and sellers" against claims by the other, either of

---

[28] *E.g.*, *Bridgeport Energy, LLC*, 118 F.E.R.C. ¶ 61,243, PP 41-42 (2007) (conditioning settlement acceptance on removal of a *Mobile-Sierra* provision); *Wabash Valley Power Ass'n*, 107 F.E.R.C. ¶ 61,327, P 11 (2004) ("The 2000 Contract, filed here for the first time, arguably attempts to bind the Commission to a 'public interest' standard of review when the Commission first reviews that contract. We will not apply a 'public interest' standard in cases where we have not previously determined the contracts to be just and reasonable.") (footnote omitted); *Fla. Power & Light Co.*, 67 F.E.R.C. ¶ 61,141, at 61,396 (1994) (Contracting parties "may not unilaterally preclude the Commission from fulfilling its statutory responsibility, under [FPA] section 205 ..., to review the rates, terms and conditions of an agreement to ensure that they are just and reasonable ....").

whom "can make bargains which in hindsight prove improvident."[29]

The Ninth Circuit properly construed Section 206. FERC's duty to assess a contract's reasonableness to the *public* protects *neither* the buyer nor the seller directly but focuses on *non-parties* to the contract—including, notably, ultimate consumers.[30] Consumer protection is a paramount concern in both low- and high-rate cases. Consumer harm occurs in low-rate cases if the rate threatens continuation of service or shifts cost responsibility to other consumers. *Sierra*, 350 U.S. at 355. Consumer harm occurs in high-rate cases when the costs of unreasonable wholesale contracts are passed on to ultimate consumers.[31]

---

[29] FERC Br. at 40 (quoting *Boston Edison Co. v. FERC*, 856 F.2d 361, 372 (1st Cir. 1988)) (emphasis added); *compare* FERC Opp. Cert. at 20-21 (denying that the Ninth Circuit "create[d] a rule ... biased against sellers" and noting that "even under the just-and-reasonable standard, a purchaser may not claim 'buyer's remorse' and be excused from a long-term contract simply because market prices have fallen during the term of the contract").

[30] As explained below, contracting parties' interests do not always align with the public interest.

[31] Consumer harm also may occur because unreasonable long-term contracts formed under uncompetitive conditions have long-term market-distorting effects. FERC must take into account "the anticompetitive effects of regulated aspects of interstate utility operations pursuant to ... directives contained in §§ 205, 206...." *FPC v. Conway Corp.*, 426 U.S.

Assuming *arguendo* that *Mobile-Sierra* precluded inquiry into the contracts' reasonableness to Respondents, the Ninth Circuit correctly remanded for FERC to determine whether the contracts produced unreasonable rates affecting ultimate consumers.

D. MBR Agreements Represent One of Many Contexts In Which Mobile-Sierra Is Invoked.

As national organizations, APPA and NRECA ask the Court to recognize that this case involves just one of many contracting contexts in which *Mobile-Sierra* is invoked. Here, the contracts at issue were arms'-length agreements between buyers and sellers with opposed interests and unequal bargaining power resulting from uncompetitive market conditions. In other cases, contracting parties may *join* forces to advance shared interests at the expense of third parties or the public. And in still other cases, increasingly common in today's restructured energy industry, contracting parties may be simply indifferent to costs that can be externalized or that they are virtually assured of passing through to others.[32]

271, 279 (1976).

[32] In this case, the alignment of Respondents' interests with the consuming public's interest in reasonable rates allows

For example, Reliability Must-Run ("RMR") agreements superficially resemble bilateral purchase-sale agreements similar to those at issue here. *See Bridgeport*, 118 F.E.R.C. ¶ 61,243, at P 41 ("RMR agreements are contracts between a generator and the ISO [Independent System Operator] that commit a generator to provide reliability service in return for fixed monthly payments by load in the affected zone."). But such RMR agreements are negotiated by not-for-profit ISOs that do not pay the resulting costs—which are passed directly to consumers—and therefore lack incentives to reduce such costs. *See NSTAR Elec. & Gas Corp. v. FERC*, 481 F.3d 794, 803 (D.C. Cir. 2007). FERC also has determined that such agreements harm markets and should be accepted only as a "last resort" when necessary to maintain system reliability. *Bridgeport* at P 41.

FERC thus has rejected attempts to invoke *Mobile-Sierra* to foreclose complaints seeking to terminate RMR agreements, holding that it "would

---

amici to characterize protection of the consuming public as indirect protection of Respondents. *See* Coral Br. at 26; Br. of Electric Power Supply Ass'n et al. at 29. But *Mobile* expressly allowed for modification when a party's "interests coincide with the public interest." 350 U.S. at 344. Moreover, in many *other* contexts, *neither* party's interests will align with the public interest. The Court must not tie FERC's hands in such cases out of misplaced concern that protecting the public interest will allow Respondents to accomplish indirectly what Petitioners and FERC say they cannot do directly.

be inconsistent with our duty under the [FPA] to be bound to the higher 'public interest' standard when reviewing RMR agreements." *Id.* at P 41; *see also Milford Power LLC*, 119 F.E.R.C. ¶ 61,167, P 31 (clarifying that non-parties, as well as FERC, may challenge RMR agreements under a just-and-reasonable standard), *reh'g denied*, 121 F.E.R.C. ¶ 61,042 (2007), *appeal dismissed sub nom. Blumenthal v. FERC*, No. 07-1270 (D.C. Cir. Oct. 25, 2007). Petitioners' position here would *require* FERC to accept such provisions and to allow RMR agreements to remain in effect as long as the contracting parties wished, unless "unequivocal public necessity" dictated otherwise.

FERC also has refused to accept *Mobile-Sierra* provisions seeking to insulate aspects of the relationship between ISOs and transmission-owning public utilities ("TOs"). For example, in 2003, a group of New England TOs and New England's ISO entered into an agreement to facilitate formation of a regional transmission organization ("RTO"). FERC rejected the TOs' proposal that "the *Mobile-Sierra* 'public interest' standard govern FERC review of termination and withdrawal" from the RTO, *Me. Pub. Utils.*, 454 F.3d at 281, finding (*inter alia*) that such withdrawal could "have a substantial [deleterious] impact on other market participants and the markets themselves," *id.* at 286 (quotation omitted), and that the threat of withdrawal "could

subvert the independence of the RTO," *id.* at 287. The D.C. Circuit affirmed, noting that "there is no expectation of contract stability when a contract is submitted to FERC for the first time, has yet to be approved ..., and has not yet gone into effect—particularly when that contract is a complex agreement establishing a new regional structure impacting all market participants." *Id.* at 284.

FERC's position here, that contracts may not be reformed absent "exceptional circumstances of unequivocal public necessity," Br. at 37 (quotations omitted), involving "harm of comparable severity" to threatened discontinuation of service, *id.* at 39, cannot be squared with FERC's reformation of contracts in the above-cited cases. More fundamentally, as FERC recognized in those cases, FERC may not abdicate its statutory duty to protect the public through blind reliance on contracting parties' self-interest. FERC's and Petitioners' position here would disable FERC from protecting non-parties and the public against all but the severest harms, even in cases where the contracting parties' interests diverge from the public interest. The Court must reject such sweeping and misguided positions.

III. FERC MAY NOT ACCEPT UNREASONABLE CONTRACTS TO PROMOTE FUTURE CONTRACTING.

Petitioners and *amici* claim that modifying contract rates entered under uncompetitive conditions will deter sellers from contracting during future periods of market dysfunction. *E.g.*, Coral Br. at 25; Br. of Calpine Energy Servs. et al. at 51-52.

Such arguments focus on only one side of the equation, however. Refusing to modify long-term rates formed under uncompetitive conditions, while simultaneously refunding unreasonable *short*-term rates charged during the same period, will deter *buyers* from entering long-term contracts when FERC urges them to do so, as it did here.

Moreover, exclusive focus on sellers' incentives proves too much. Monopolists have strong incentives to monetize market power by entering into long-term, uncompetitive contracts. They have strong (albeit self-serving) reasons to claim that reducing prices to reasonable levels will undermine incentives to enter into future contracts. But the FPA does not allow such assertions, or even FERC's own views of the potential responses of capital markets, to trump other considerations under the Act. *Permian Basin*, 390 U.S. at 791 (FERC "cannot confine its inquiries either to the

computation of costs of service or to conjectures about the prospective responses of the capital market."); *Texaco*, 417 U.S. at 400 ("It may also be that control of prices ... is counterproductive to the interests of the consumer in increasing the production of natural gas[, but i]t is not the Court's role ... to overturn congressional assumptions embedded into the framework of regulation established by the Act.")

Finally, efficient economic outcomes do not require FERC to enforce contracts entered into under *un*competitive conditions. All that is required is that FERC enforce *reasonable* contracts entered into in *competitive* markets.

CONCLUSION

Therefore, the Court should affirm the Ninth Circuit's decision remanding these cases to FERC.

Respectfully submitted,

SCOTT H. STRAUSS
Counsel of Record
MARK S. HEGEDUS
JEFFREY A. SCHWARZ
SPIEGEL & MCDIARMID LLP
1333 New Hampshire Avenue, NW
Washington, DC 20036

SUSAN N. KELLY
Vice President of Policy Analysis and General Counsel
AMERICAN PUBLIC POWER ASSOCIATION
1875 Connecticut Avenue, N.W., Suite 1200
Washington, D.C. 20009-5715

WALLACE F. TILLMAN
General Counsel
RICHARD MEYER
Senior Regulatory Counsel
NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
4301 Wilson Boulevard
Arlington, VA 22203-1860

Counsel for Amici Curiae
American Public Power Association and
National Rural Electric Cooperative Association

January 14, 2008